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What is buyback?

Buyback of shares is when a company re-purchases its own shares from its shareholders. In a buyback issue, the company pays its shareholders the fixed value per share and re-absorbs that portion of its ownership that was previously distributed among public and private investors. The process enables the repurchase of shares from the existing shareholders usually at a higher price than the market price¹.

There could be several objectives as to why a company opts for buyback –

1. The company has surplus cash & has very few projects to invest in. In such scenario's companies prefer to return the same to the shareholders;
2. Under the current tax regime, when a company buybacks the shares from the shareholder's, the moneys so received by the shareholders are exempt. Hence, buyback of shares is tax efficient method of distribution of income in the hands of shareholders;
3. Incase the company feels that its stock is under-valued, it can repurchase its shares from the shareholders & then re-issue these at a later stage;
4. The promoters of the company may want to consolidate their shareholding and maintain their stake in the company.

Tax Implications of Buyback

The Finance Act 2013 introduced the concept of taxing income distributed to the shareholders on buyback.

The Memorandum explaining the provisions of the Finance Bill 2013 are as under:

“Unlisted companies, as a part of tax avoidance scheme, are resorting to buyback of shares instead of payment of dividends in order to avoid payment of tax by way of DDT particularly where the capital gains arising to shareholders are either not chargeable to tax or taxable at a lower rate.

In order to curb such practice, it is proposed to amend the Act, by insertion of new Chapter XII-DA, to provide that the consideration paid by company for purchase of its own unlisted shares which is in excess of sum received by the company at the time of issue of such shares (distributed income) will be charged to tax and the company would be liable to pay additional income tax at 20% of the distributed income paid to the shareholder. The additional income tax payable by the company shall be the final tax on similar lines as dividend distribution tax. The income arising to the shareholders in respect of such buyback by the company would be exempt where the company is liable to pay additional income tax on the buy back of shares.”

Thus, with the aforesaid intent in mind, s. 115QA of the Income Tax Act 1961 was inserted which laid down the provisions relating tax on income distributed to shareholders.

Section 115QA is applicable as under :

1. A domestic company distributes income to its shareholders on buy – back of its shares.
2. The provisions of this section are applicable to both unlisted & listed companies. However, it is to be noted that incase of listed companies, s. 115QA shall be applicable only if the announcement for buyback is made only or before 5th July 2019.
3. Additional income tax payable by the company shall be 20% [+SC+ HEC] on distributed income.

¹ <https://www.moneycontrol.com/news/business/markets/why-do-companies-opt-for-share-buyback-route-5338421.html>

4. Explanation to s. 115QA states that '*buy-back*' means purchase by a company of its own shares in accordance with the provisions of s. 77A of the Companies Act or any other law for the time being in force. '*Distributed Income*' is any consideration paid by the company on buy-back of shares as reduced by the amount, which was received by the company for issue of shares, determined in the manner as may be prescribed.
5. Additional tax under s. 115QA of the Income Tax Act 1961 shall be paid in addition to the total tax payable by the company. Such additional tax is payable irrespective of whether the company is liable to pay income tax or no.
6. The company is liable to remit the additional tax within fourteen days of payment to the shareholders. It is to be noted that no credit shall be claimed by the company or any other person in respect of such additional tax paid.
7. The company or the shareholder shall not be eligible for any deduction in respect of the aforesaid tax.

Section 115QB provides for levy of interest which is as under:

If the company fails to pay the additional tax within the due date prescribed under s. 115QA above, interest at the rate of 1% per month or part thereof shall be leviable for non-payment or short payment for the period beginning immediately after the last date on which tax was payable and ending with the date of actual payment.

The Finance Act 2013, introduced s. 115QA of the Income Tax Act 1961 wherein the concept of tax on buyback was introduced and the same was applicable to unlisted companies only. The Finance Bill 2019, amended s. 115QA to extend the applicability to listed companies as well.

Further, we also wish to draw attention to the fact that the income received by shareholders on distribution of income is exempt in their hands under s. 10(34) of the Income Tax Act 1961.

ILLUSTRATION

Company A decides to buyback its shares from its existing shareholders. The total number of shares it decides to buyback is 50,000 at the rate of INR 80 per share. Initially, the shares were issued to the shareholders at the rate of INR 20 per share. The calculation of additional tax under s. 115QA is as under :

S.No	Particulars	INR
A	Amount paid by Company A to its shareholders on buy back (INR 80 X 50,000 shares)	40,00,000
B	Less : Amount received at the time of allotment (INR 20 X 50,000 shares)	(10,00,000)
C	Distributed Income (A – B)	30,00,000
D	Tax on distributed income (C X 20%)	6,00,000
E	Add : Surcharge at 12% (D X 12%)	72,000
F	Add : Health & Education Cess at [4% (D+E)X4%]	26,880
G	Total Tax Liability of company A under s. 115QA (D+E+F)	6,98,880

Note : s. 115QA of the Income Tax Act 1961 is applicable to both unlisted & listed companies. Hence, irrespective of whether Company A is a listed or unlisted company, Section 115QA would be applicable & tax on distributed income would be payable. Further, it is pertinent to note that irrespective of whether income tax under normal provisions is payable by the company or not, additional tax under s. 115QA shall be payable.

Buyback V/s Dividend Payout

As per an amendment made by Budget 2020, DDT is no longer required to be paid by companies and such dividend is taxable in the hands of the shareholders at the applicable tax rates.

BUYBACK	DIVIDEND
<p>A Company may purchase it's own shares & other specified securities out of:</p> <ul style="list-style-type: none">a. It's free reserves;b. The securities premium account;c. The proceeds of the issue of any kind of shares or other specified securities <p>The maximum buy back is 25% or less of the aggregate of paid capital & free reserves of the company. Provided that in respect of the buy back of equity shares in any financial year, the reference to 25% in this clause shall be construed with respect to it's total equity capital for that year.</p>	<p>Dividend can be distributed by the company from</p> <ul style="list-style-type: none">a. Out of the profits of the financial year under consideration;b. Out of the profits of earned in the previous financial year or years;c. Both of the above

Tax Implications under both the scenarios :

Buyback :

Particulars	INR
Distributed Income	10,00,000
Tax on Distributed income @ 23.30%	(2,33,000)
Income paid to shareholders [(Exempt in hands of shareholders under s. 10(34))]	7,67,000

Dividend:

Particulars	Shareholder slab rate 5% (INR)	Shareholder slab rate 20% (INR)	Shareholder slab rate 30% (INR)
Dividend Paid to Shareholder	10,00,000	10,00,000	10,00,000
Tax Payable by shareholder as per his applicable slab rate	(52,000)	(2,04,000)	(3,09,000)
Income Available to Shareholder	9,48,000	7,96,000	6,91,000

In the aforesaid scenario, it becomes evident that the dividend option is more beneficial to a resident shareholder who falls in the 5% and 20% slab rate. However, for an individual who falls within 30% slab rate, buy back is more beneficial.

Buyback activities of the years

[HTTPS://WWW.LIVEMINT.COM/COMPANIES/NEWS/FIVE-INDIAN-COMPANIES-THAT-ARE-BUYING-BACK-SHARES-BIG-TIME-11631185251362.HTML](https://www.livemint.com/companies/news/five-indian-companies-that-are-buying-back-shares-big-time-11631185251362.html)

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BUYBACK OFFERS IN 2021.

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